Summary

- Economic recovery continues albeit unevenly. While growth is rapid in many emerging economies, it remains fragile in most advanced economies.
- Euro zone countries and the IMF agreed on a three-year programme worth $146 billion to support Greece amidst drastic fiscal austerity measures and risks of contagion to other European economies.
- An additional stabilization scheme worth $930 billion was subsequently made available for the euro zone.

Global issues

The Greek crisis has morphed from a fiscal crisis in a single country to a regional crisis for the euro zone and has sent shock waves through stock markets worldwide. Contagion in debt markets led sovereign bond spreads to widen significantly for several European countries, while the cost of insuring these holdings through credit default swaps (CDS) has skyrocketed. This was exacerbated by the downgrading of Greek, Portuguese and Spanish bonds during April, making the financing of their deficits more costly and raising questions about possible future problems that may eventually require bailouts or restructuring. The financial health of the banks that are holding this debt—the bulk is held by European banks—has now deteriorated raising concerns for renewed troubles in the banking sector, which has yet to fully recover from the global financial crisis. To add insult to injury, some observers have questioned the viability of the European Monetary Union itself, amidst fears that some countries might be forced to exit from the common currency. This has led to a loss of confidence in the euro which has fallen against the dollar from $1.45 at the beginning of the year to below $1.30.

World trade continues to pick up gradually. In most developing regions, trade volumes have almost returned to pre-crisis levels, owing to the robust growth in some large developing economies and the restocking of inventories. However, in developed economies, the trade recovery remains subdued. For the first two months of 2010, exports in Europe and the United States experienced only modest year-on-year increases of 7 per cent and 15 per cent, respectively. Japan, by contrast, has registered a faster rebound, with exports growing by 36 per cent. However, aggregated export volumes in developed regions are still 14 per cent lower than two years ago. As trade among developed economies represents more than 40 per cent of the world total trade flows, a return of global trade to pre-crisis levels should not be expected any time soon despite the strong recovery of developing country exports.
Developed economies

United States: consumption and restocking of inventories lead GDP growth

Preliminary estimates for growth of gross domestic product (GDP) of the United States during the first quarter of 2010 indicate further recovery. GDP grew at an annualized rate of 3.2 per cent from the previous one. Growth is mainly driven by private consumption which at 3.6 per cent, reached the fastest quarterly pace since mid-2007 and contributed to about 80 per cent of aggregate output growth. Further, after seven continuous quarters of de-stocking, firms have started to rebuild their inventories, contributing about 1.6 percentage points to GDP growth. In contrast, declining net exports owing to strong import growth and fiscal contraction by state and local governments had a negative impact on growth (combining to -1.1 percentage points). Agriculture and industry showed sustained and solid recovery over the past three quarters, expanding at an annualised rate of 14 per cent. Meanwhile, services sectors expanded at a meagre 1 per cent during the quarters. Despite the strong rebound in goods production, the rate of unemployment rate remains high at close to 10 per cent of the work force.

Western Europe and the EU: Greece reaches agreement with EU and IMF on rescue package

The recovery remains on track in Western Europe. Industrial production continued its upward trend, but remains 15.9 per cent below its peak of April 2008. The European Commission’s Economic Sentiment Indicator improved significantly in April, moving above its long term average for the first time since the crisis while capacity utilization continues to increase reaching 73.5 per cent in the euro area from its record low of 69.6 per cent in the third quarter of 2009. Unemployment remained at 10 per cent in March for the euro area, gaining only 0.2 percentage points since July 2009, suggesting some overall stabilization in labour market conditions across the region. Germany has actually seen some tentative decline of 0.2 percentage points since its peak last fall, but in a number of other countries the jobless rate continues to inch up.

The Greek fiscal crisis progressively deepened during April. With the downgrading of its debt to below investment grade, the Greek Government was forced to officially request foreign assistance. An agreement was finally reached with the IMF and the European Commission on a financing package worth €110 billion ($146 billion) to cover its borrowing needs through the end of 2012. In addition, the European Central Bank (ECB) suspended indefinitely the minimum credit rating threshold for collateral eligibility requirements for Greek sovereign debt. The package requires Greece to implement drastic fiscal austerity measures. Public debt currently is estimated to amount to 115 per cent of GDP, while the budget deficit was 13.6 per cent of GDP in 2009. The fiscal adjustment plans should bring the deficit to below 3 per cent of GDP by 2014. The announcement of this package did not calm the markets however, and within a few days a second and far more ambitious package was agreed upon, a stabilization scheme worth as much as €720 billion ($930 billion) available for any euro country running into severe difficulties. It consists of government-backed loan guarantees and bilateral loans worth up to $568 billion provided by euro zone members; a further $77 billion supported by all EU members through expansion of an existing balance of payments facility; and up to $284 billion provided by the IMF. In addition, the ECB announced it would for the first time intervene in government bond markets. It also joined the US Federal Reserve and other main central banks in reactivating extra US dollar liquidity facilities.

New EU member States: Lithuanian economy not out of the woods yet

Lithuania’s economy declined again in the first quarter of 2010, after two consecutive quarters of growth. On a seasonally and working-day adjusted basis, output contracted by 4.1 per cent quarter on quarter. The construction sector recorded the largest decline, while output of export-oriented industries suffered a mild contraction. As is the case in the other Baltic States, a return to positive growth during 2010 is uncertain and hinges on export performance. The rise in energy prices earlier this year, accentuated by an unusual cold winter and the earlier closure of a nuclear power plant, restrained both business and consumer spending.

In most of Central Europe, industrial production continued to recover. The year-on-year figure for Hungary in February was 8.4 per cent, while it reached 12.3 per cent in Poland in March, partly due to a turnaround in the inventory cycle. As inflationary pressures among the new EU member States remain low, the Hungarian Central Bank reduced interest rates by 25 basis points in April in a further effort to boost the economy.

Unlike its regional peers, Estonia narrowed its budget deficit to 1.7 per cent of GDP in 2009, despite a 14.1 per cent economic contraction. The European Commission proposed that Estonia could join the euro area in 2011.

Japan: economic activity rebounds amidst deflation

Economic activity in Japan continued its rebound. Exports and industrial production have increased, partly in response to global inventory adjustments and to the growth recovery in emerging economies. Private consumption also increased, supported by stimulus measures. The decline of business fixed investment came to an end, but public investment, in turn, started to decrease.
The core consumer price index (CPI) fell year-on-year by 1.2 percent in March, marking a thirteenth month of declining prices. For the fiscal year of 2009, the CPI declined by 1.6 per cent. At the end of April, the Bank of Japan decided to maintain its overnight call rate target at 0.1 per cent amid persistent deflation, but ended its programme of equity purchases. The Bank of Japan has purchased stocks held by commercial banks for a total amount of ¥387.8 billion ($4.1 billion) since February 2009, as part of the set of unconventional measures taken in response to the global financial crisis.

Economies in transition

CIS: uneven performance and political turbulence in the CIS

Performance in the CIS continues to be uneven. Economic performance in the Russian Federation has been mixed in the first two months of 2010. Industrial output increased by 4.9 per cent year on year. Retail sales only grew by 0.8 per cent, while construction declined by 10 per cent. With inflation weakening further to 6.5 per cent in March, the refinancing rate was lowered three times by 25 basis points in February, March and April in order to stimulate the economy. Azerbaijan, the region’s best performer with GDP growth registering 9.3 per cent in 2009, also showed firm performance in the first quarter of 2010. Quarter-on-quarter growth reached 5.4 per cent, benefiting from strongly expanding activity in extractive industries. Meanwhile, retail trade and industrial output expanded by 8.3 per cent and 5.6 per cent, respectively.

At the beginning of April, the president of Kyrgyzstan was ousted after violent street protests triggered by increases in utility prices and the dissatisfaction about the ruling party. An interim Government has since been installed and new elections have been scheduled for October.

South-eastern Europe: signs of economic upturn in Serbia

The economy of Serbia has shown signs of recovery, with industrial output expanding by 3 per cent and exports growing by 30 per cent year on year in the first two months of 2010, in line with expansions in the basic metals and chemicals sectors. Increasing retail sales point to a revival in domestic demand. The employment level also increased slightly. The national currency continued to depreciate in March, owing to lower FDI inflows. The Government plans to spend on infrastructure spending during 2010, in particular for motorway construction.

In Croatia, the Government presented its Economic Recovery Programme in April, aiming to increase competitiveness and boost exports so as to make GDP growth less reliant on domestic demand and to reduce the large current account deficit. The programme includes privatization of state enterprises and tax breaks to companies.

Developing economies

Africa: recovery gaining momentum

Africa’s economies are showing further signs of recovery. Economic conditions in Maghreb improved further. In Morocco and Tunisia, real GDP increased by 5.0 and 7.8 per cent, respectively, in the last quarter of 2009. After a sharp slowdown in the first semester, the two countries experienced a significant rebound in most manufacturing sectors. Tunisia’s the textile industry, the backbone of the country’s manufacturing sector, forms an exception as its output contracted for the fourth consecutive quarter.

The region’s exporters of gold benefited from a steady rebound in world market prices. The gold price increased by more than 60 per cent since the end of 2008. While, world gold production has declined over the last ten years, West Africa’s combined gold output from Ghana, Mali, Guinea, Burkina Faso, Mauritania and Côte d’Ivoire output has risen more than 65 percent over the last five years to about 190 tonnes per year. This upward trend is expected to continue. Burkina Faso, for instance, is forecast to double its gold production for the second consecutive year in 2010 to reach a level of approximately 22 tonnes as new mines go on stream.

East Asia: economic growth accelerates in first quarter of 2010

During the first quarter of 2010, East Asia’s economies maintained their fast pace of recovery while inflationary pressures stayed low. China’s year-on-year GDP growth accelerated to 11.9 per cent, that of the Republic of Korea to 9.1 per cent, and Singapore’s to 13.1 per cent. While these exceptionally high growth rates can partly be explained by a low base effect - the first quarter in 2009 was the trough of the downturn -, they also reflect a further strengthening of the recovery in recent months. Compared to the previous quarter, the Republic of Korea’s GDP increased by 1.8 per cent as government consumption grew by almost 6 per cent owing to a boost in social security expenditure. Growth in China was driven by strong domestic investment and
consumption. Net exports were a drag on GDP growth as import spending growth outpaced export earnings growth. Inflation in China declined slightly in March, averaging 2.2 per cent in the first quarter. As in most East Asian economies, inflation expectations in China are contained and within the target range of the Central Bank. In response to increasing fears of a housing market bubble, China’s authorities have undertaken significant steps to curb property sector speculation and rein in property prices.

**South Asia: strength of India’s recovery contrasts with weaknesses in the region**

Recent economic data confirm the strength of the recovery in India, but also indicate weaknesses in other South Asian economies. India’s industrial production continued to pick up in the first quarter of 2010, recording year-on-year growth of 16 per cent. This expansion was led by high growth of capital goods, intermediate goods and consumer durables, especially vehicles. In light of the strength of the domestic economy and significant inflationary pressures, the Reserve Bank of India further tightened monetary policy, raising both its key policy rates and the banks’ cash reserve ratio by 25 basis points. The authorities stressed that real interest rates remained negative as inflation continued to move up on the back of rising demand side pressures.

Export sectors across South Asia suffer from weak global demand for textiles and garments. In Bangladesh, merchandise exports declined by 6 per cent year-on-year in the second half of 2009. Meanwhile, the IMF deferred disbursement of the fifth tranche of its stand-by agreement with Pakistan, worth $1.2 billion, because the Government failed to introduce legislation to authorize introduction of a value added tax.

**Western Asia: further signs of economic expansion**

Turkey’s economy rebounded in the fourth quarter of 2009 with a year-on-year growth rate of 6.0 per cent, driven by a combination of a recovery in private consumption demand and fiscal stimulus measures. The rate of growth is further influenced by the low base of comparison. Industrial production increased by 18.1 per cent year on year in February. The rate of inflation reached 9.6 per cent in March, only slightly down from the 10.1 per cent recorded in February.

In Israel, inflation fell to 3.2 per cent in March from 3.6 per cent in February in view of slower increases in food prices and housing costs. Nevertheless, it remained above policy-makers’ target range of 1-3 per cent. Jordan passed a supplementary budget, with the deficit for the current fiscal year expected to reach about 10 per cent of GDP. Including grants, Jordan’s deficit is forecast to reach about 8 per cent of GDP, although bilateral assistance has come under increasing pressure in light of the economic crisis.

**Latin America: Mexico and Central America benefiting from external factors**

Unemployment in Brazil increased in the first quarter of 2010, despite rebounding production. Nonetheless, the Central Bank increased its benchmark interest rate by 0.75 percentage points to 9.5 per cent in April over fears of inflation.

Mexico and Central America showed clear signs of economic recovery in early 2010. Exports from Mexico to the United States increased by 32.5 per cent per year on year in February 2010. Nicaragua’s exports also increased, by 34 per cent, driven partly by higher sugar prices. Remittances to Central America and the Caribbean have started to recover, despite persistent high unemployment rates in the United States. In March 2010, remittances to El Salvador increased by 8.7 per cent, the first year-on-year increase since October 2008, and by 7.5 per cent in Guatemala. In Jamaica, remittances also increased by 7.4 per cent in February 2010. Remittances to Mexico, in contrast, are yet to recover.

Resurging flows of remittances to Central American and Caribbean countries will help contain the widening of current account deficits induced by the increase in the cost of energy imports.

**Least developed countries: growth accelerates in several African LDCs**

Unlike many least developed countries (LDCs) elsewhere, a number of LDCs in sub-Saharan Africa saw visible economic recovery from the second half of 2009. This holds in particular for the oil and metal-exporters among them. Zambia, for instance, saw its volume of copper exports increases year on year by 13 per cent in the first quarter of 2010. Several other economies are also showing clear signs of recovery. Ethiopia’s exports rose by 21 per cent in the eight months through March compared with the same period a year earlier. Economic growth in the LDCs belonging to the East African Community accelerated as well. For instance, GDP of the United Republic of Tanzania grew year-on-year by 7.1 per cent in the third quarter of 2009. Mining and tourism sectors declined sharply in the first semester of 2009, however, in these economies, but in turn experienced robust output growth in manufacturing, construction, wholesale and retail trade, transports and communication. Moreover, tea production in East Africa also increased sharply in the first quarter of 2010. Tea exports of Burundi and Rwanda grew year on year by about 50 per cent due to unusual wet weather conditions in this period and more widespread use of fertilizers.